

Oversight Division

Committee On Legislative Research

PROGRAM EVALUATION

Review of the
Department of
Natural Resources
State Revolving Funds

Program Evaluation

Department of
Natural Resources
State Revolving Funds

*Prepared for the Committee on Legislative Research
by the Oversight Division*

Mickey Wilson, CPA, Director

Review Team: Valerie Lesko, Team Leader

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THE COMMITTEE ON LEGISLATIVE RESEARCH, Oversight Division, is an agency of the Missouri General Assembly as established in Chapter 23 of the Revised Statutes of Missouri. The programs and activities of the State of Missouri cost approximately \$23 billion annually. Each year the General Assembly enacts laws which add to, delete or change these programs. To meet the demands for more responsive and cost effective state government, legislators need to receive information regarding the status of the programs which they have created and the expenditure of funds which they have authorized. The work of the Oversight Division provides the General Assembly with a means to evaluate state agencies and state programs.

THE COMMITTEE ON LEGISLATIVE RESEARCH is a permanent joint committee of the Missouri General Assembly comprised of the chairman of the Senate Appropriations Committee and nine other members of the Senate and the chairman of the House Budget Committee and nine other members of the House of Representatives. The Senate members are appointed by the President Pro Tem of the Senate and the House members are appointed by the Speaker of the House of Representatives. No more than six members from the House and six members from the Senate may be of the same political party.

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Members of the General Assembly:

The Joint Committee on Legislative Research adopted a resolution in June 2010 directing the Oversight Division to perform a program evaluation of the Missouri Department of Natural Resources, State Revolving Funds to determine and evaluate program performance in accordance with program objectives, responsibilities, and duties as set forth by statute or regulation.

The report includes Oversight's comments on internal controls, compliance with legal requirements, management practices, program performance and related areas. We hope this information is helpful and can be used in a constructive manner for the betterment of the state program to which it relates. You may obtain a copy of the report on the Oversight Division's website at <http://www.moga.mo.gov/oversight/audits.htm>.

Respectfully,

A handwritten signature in cursive script, appearing to read "Tom Flanigan".

Representative Tom Flanigan
Chairman

EXECUTIVE SUMMARY

The Missouri Department of Natural Resources was created under state reorganization July 1, 1974. The Department helps protect the environment in a safe manner, protects the state's land, air and water resources, and preserves the state's historic and natural areas by maintaining state parks and historic sites.

To protect the State's water resources a water protection program was set up within DNR. This program is a part of the Division of Environmental Quality. A key part of this program is the federal Clean Water Act that established the basic structure for regulating discharges of pollutants in the waters of the United States and regulating quality standards for surface waters.

In 1992 DNR implemented the State Revolving Fund program. This is a federally subsidized low-interest, leveraged-loan program coordinated with the Environmental Protection Agency's Capitalization Grant which is matched with state funds equal to 20 percent of the annual grant amount. DNR administers the federal funds and generates matching funds with state water pollution control bonds proceeds. The federal government requires funds to be used for eligible projects and low interest loans.

Oversight's program evaluation revealed DNR does comply with all required procedures however, the reports can seem very unclear to someone unfamiliar with the large amount of information provided in these reports. A clearer approach should be taken including what is being funded, federal and state percentages for each project, and a general description of each project. More concentration should be given providing information to communities regarding the program as well as the other funding sources available for these projects.

There were also indications on a revision of the structure of the loan program for additional flexibility. The possibility of a hybrid cash flow model loan program or reserve fund model was one of the possible solutions. However, there is no written description of this structure or how the additional flexibility will be modeled. Also, there is no written implementation on the possibility of using the hybrid cash flow loan program.

The program evaluation also revealed DNR transferred funds from one revolving fund to another revolving fund in 2001, however, the guidelines for this transfer were vague. There were indications the transfer/reallocation would be repaid at the earliest possible date however this has not occurred. There were also indications of a possibility of additional transfers in the future, however, there are no specific guidelines on how this will occur, what precedents would indicate the possibility of a transfer and if a transfer is done how and when the repayment would occur.

Chapter 1

Purpose/Objectives

The General Assembly has provided by law that the Joint Committee on Legislative Research may have access to and obtain information concerning the needs, organization, functioning, efficiency and financial status of any Department of state government or of any institution that is supported in whole or in part by revenues of the state of Missouri. The General Assembly has further provided by law for the organization of an Oversight Division of the Joint Committee on Legislative Research and, upon adoption of a resolution by the General Assembly or by the Joint Committee on Legislative Research, for the Oversight Division to make investigations into legislative governmental institutions of this state to aid the General Assembly.

The Joint Committee on Legislative Research directed the Oversight Division to perform an evaluation of all state revolving funds that are administered by the Department of Natural Resources (DNR) for the purposes of funding wastewater and drinking water infrastructure improvement projects.

Oversight's review addressed, but was not limited to the following:

1. Review of the purpose of the state revolving funds.
2. Compliance with state and federal laws and regulations.
3. Determine whether the program meets the original legislative intent.

Scope

The scope of the evaluation concentrated on the period of July 1, 2005 through June 30, 2010, State Fiscal Years 2006 through 2010.

Methodology

The methodology used by the Oversight Division included reviewing the Constitution of the State of Missouri, statutes, rules and regulations, organizational charts, annual reports, financial statements, analyzing budget and actual expenditure information, as well as interviewing Department of Natural Resources personnel.

Background

The Missouri Department of Natural Resources (DNR) was created under state reorganization July 1, 1974. The Department helps protect the environment in a safe manner, protects the state's land, air and water resources, and preserves the state's historic and natural areas by maintaining state parks and historic sites.

To protect the State's water resources a water protection program was set up within DNR. This program is a part of the Division of Environmental Quality.

A key part of this program is the federal Clean Water Act (CWA) that established the basic structure for regulating discharges of pollutants into the waters of the United States and regulating quality standards for surface waters. The basis of the CWA was enacted in 1948 and was called the Federal Water Pollution Control Act, but the Act was significantly reorganized and expanded in 1972. The "Clean Water Act" became the Act's common name when amended in 1977.

The 1977 amendments included the following:

- Establishing the basic structure for regulating discharges into the waters of the United States;
- Gave the EPA the authority to implement pollution control programs such as setting wastewater standards for industry;
- Maintaining existing requirements to set water quality standards for all contaminants in surface waters;
- Made it unlawful for any person to discharge any pollutant from a point source into navigable waters, unless a permit was obtained under its provisions;
- Funding the construction of sewage treatment plants under the construction grants program;
- Recognizing the need for planning to address the critical problems posed by nonpoint source pollution.

Subsequent amendments modified some of the earlier CWA provisions. Revisions in 1981 streamlined the municipal construction grants process and improved the capabilities of treatment plants built under the program. Changes in 1987 phased out the construction grants program, replacing it with the State Water Pollution Control Revolving Fund, more commonly known as the Clean Water State Revolving Fund. These changes created new funding strategy addressing water quality needs by building on EPA/state partnerships.

The mission of the Public Drinking Water Program (PDWP) is to assure that public water systems provide safe and adequate drinking water. This program helps ensure that Missourians drink from public water supplies that meet current health standards. The program helps prevent health risks by monitoring more than 100 chemicals, certain bacteria, and radiological contaminants that could cause acute sickness, or long-term or chronic health effects.

The Safe Drinking Water Act (SDWA) is the principal federal law in the United States that ensures safe drinking water for the public. The act states the Environmental Protection Act (EPA) is required to set standards for drinking water quality and oversee all states, localities, and water suppliers who implement these standards. The SDWA applies to every public water system in the United States. There are currently more than 160,000 public water systems in the United States providing water to almost all Americans at some time in their lives. It should be noted that this act does not cover private wells. Also, the act does not cover bottled water. Bottled water is regulated by the Food and Drug Administration.

On August 6, 1996, President Clinton signed into law the Safe Drinking Water Act Amendments of 1996 (P.L. 104-182). Section 1452 of this Act authorizes the Administrator of the U.S. Environmental Protection Agency to establish a Drinking Water State Revolving Fund (DWSRF) program. This program makes capitalization grants to each state for the purpose of establishing a perpetual Drinking Water Revolving Fund (DWRF). Financial assistance is provided for costs of infrastructure needed to achieve or maintain compliance with the Act and to protect the public health and to allow states to carry out prevention programs.

In 1992 DNR implemented the State Revolving Fund program. This is a federally subsidized, low-interest, leveraged-loan program coordinated with the Environmental Protection Agency's (EPA) Capitalization Grant which is matched with state funds equal to 20 percent of the annual grant amount. DNR administers the federal funds and generates matching funds through the sale of Environmental Improvement and Energy Resources Authority (EI ERA) bonds....State match for the CWSRF was formerly provided through the sale of state water pollution control bonds, whereas, state match for the DWSRF was formerly provided through general revenue appropriations.

A municipality or water district desiring to build, expand or improve their drinking water facility can borrow money from the fund after voting General Obligation or Revenue bonds to secure their proposed debt. The bonds are purchased and resold nationally by a sub-unit of the Department of Natural Resources known as the Environmental Improvement and Energy Resources Authority (EI ERA). Presently the bonds are rated AAA. The funds generated by the sale of the bonds are deposited with a trustee bank in the applicant's name and are used for construction.

During the period of 1989 - 1994 the SRF provided financing at approximately one half the market rate; however, the SRF currently provides financing at 30 percent of the market rate, and has done so since 1995. In addition, it finances 100 percent of eligible planning, design, and construction. Loans with a maximum 20-year repayment term from completion of first contract and subsidized interest rates will be made available to eligible applicants meeting the minimum credit criteria. As construction costs were incurred, state and federal funds are deposited into a reserve account in an amount equal to 70 percent of the cost. Interest earned on the reserve is credited to the interest portion of the debt service charge on the bonds thereby providing the interest subsidy to the recipient. Due to recent economic conditions, the State Revolving Fund program has transitioned to a 'hybrid cash flow model loan program'.

Under the 'hybrid cash flow model loan program', the Department of Natural Resources purchases the debt obligations of the participant directly. As construction progresses funds are released to the participant so the construction costs can be paid. Upon completion of the project, the loans are adjusted to reflect the final loan amount. The repayments of these "direct loans" are then pledged to the EIARA. At such time as the State Revolving Fund program needs to replenish their funding the EIARA exercises their authority to sell bonds. The proceeds of this sale are deposited into the State Revolving Fund program account. The principal and interest payments on the EIARA bonds are secured through the pledge of the direct loan repayments from previous State Revolving Fund program participants.

Chapter 2

Clean Water State Revolving Fund

The Missouri Department of Natural Resources (DNR), Water Protection Program (WPP) is the delegated authority for the administration of federal funds made available under the Clean Water Act. Included in the Clean Water Act is the Clean Water State Revolving Fund (CWSRF) program. This program is available to fund a wide variety of water quality projects including all types of nonpoint source, watershed protection or restoration, and estuary management projects as well as more traditional municipal wastewater treatment projects.

The purpose of the CWSRF is to provide financing at below market interest rates.

Key features of the CWSRF program include:

- Low Interest Rates, Flexible Terms
- Significant Funding for Nonprofit Source Pollution Control and Estuary Protection
- Assistance to a Variety of Borrowers
- Partnerships with Other Funding Sources

CWSRF assistance has primarily been used to provide discounted loans and to purchase or refinance municipal debt obligations. Interest rates provided to borrowers is currently 30 percent of the market rate. The funds are prioritized by the State depending on the unique water quality needs and are available to communities, homeowners, farmers and other eligible entities for wastewater infrastructure, nonpoint estuary projects.

The Departments' of Veterans Affairs and Housing and Urban Development, and the Independent Agencies Appropriations Act, 1998 (Public Law 105-65, Appendix A) authorized limited cross-collateralization between the Clean Water State Revolving Fund (CWSRF) and the Drinking Water State Revolving Fund (DWSRF). Cross-Collateralization allows states to use CWSRF funds as security for bonds issued to finance DWSRF projects and vice versa. The cross-collateralization of the two funds may enhance the lending capacity of one or both SRFs. State statute 644.122 RSMo. (Appendix B) provides the state's legal authority to implement cross-collateralization.

Drinking Water State Revolving Fund

To ensure a safe drinking water system, the Drinking Water State Revolving Fund (DWSRF) is provided to assist in financing. States can use federal capitalization grant money awarded to them to set up an infrastructure funding account from which assistance is made available to public water systems. Loans made under the program can have interest rates between zero percent and market rate and repayment terms of up to 20 years. Loan repayments to the State will provide a continuing source of infrastructure financing into the next century. Emphasis is also placed on small and disadvantaged communities and on programs that emphasize prevention as a tool for ensuring safe drinking water.

Both publicly and privately owned community water systems are eligible for funding under the DWSRF program. Eligible projects include installation and replacement of failing treatment facilities, eligible storage facilities and transmission and distribution systems. Projects to consolidate water supplies may also be eligible.

A priority system is developed for funding projects based on three criteria from the SDWA. The projects are ranked and then loans are offered to systems based on their ranking order. Priority is given to those projects that:

- (1) address the most serious risk to human health;
- (2) are necessary to ensure compliance with the requirements of the Safe Drinking Water Act; and
- (3) assist systems most in need, on a per household basis.

Public involvement is an important element of both the DWSRF and the SDWA. States must provide information about their program and the projects they intend to fund in an "Intended Use Plan" that is made available to the public for review and comment, prior to award of the capitalization grant from the EPA to the State.

Comment 1

The Environmental Protection Agency, Office of Management and Budget, General Accounting Office, and Congress are charged with overseeing the Drinking Water State Revolving Fund (DWSRF) program operations in order to ensure compliance, efficiency, and effective implementation of program activities.

As was previously stated, in Missouri this program is carried out by the Department of Natural Resources' Water Protection Program.

To provide these services there are program guidelines for the DWSRF including the development of the Intended Use Plan (IUP), the DWSRF Annual/Biennial Report, and annual program audit.

The IUP lays out how the DWSRF program will employ all of its available funds, including federal capitalization grants, state matching funds, loan repayments, fund interest earnings, loan fees, and bond proceeds deposited into the fund. States may submit a two-part IUP, one part for the set-asides and another for the fund itself, however, Missouri includes the set-asides in one IUP.

The contents of the IUP have to include the short-term and long-term program goals, a summary of the DWSRF accounts, set-aside and disadvantaged community budgeting, a project priority list and ranking methodology and discussion of the public review process. The short-term goals identify the upcoming year's activities. The long-term goals communicate how the state is maximizing program effectiveness and how program objectives support national goals set forth through the State Drinking Water Act (SDWA).

Additionally, the IUP provides a summary of program account balances, the amounts available for loans, set-aside activities, and subsidies to disadvantaged communities. It includes details for all fund activities and the total amounts collected through fee accounts. For fees placed in separate, non-project accounts to pay for program administration, the state must certify that these funds will be only used for DWSRF purposes and properly audited.

Any project funded must appear on a state DWSRF priority list made available for public view. Programs must assign every project a priority and expected funding schedule. Water system name and service area population must accompany each fundable project. Additionally, a project description and expected loan terms for each proposed assistance agreement must be listed. Once fundable projects have been identified, they are to be funded in priority order.

Deviations from the priority list are subject to certain program requirements including

established bypass procedures. Any changes to the original funding order, according to bypass procedures, must be explained in the Biennial Report and during the annual review process.

In order to draw federal dollars into its set-aside accounts to support program activities, a DWSRF program must first illustrate how it will spend these funds according to a formal plan. They must submit detailed annual or multi-year work plans that list the total dollar amount or multi-year work plans that list the total dollar amount and percentage of the DWSRF capitalization grant to be used for set-aside activities. Each set-aside must include specific goals and objectives, schedule of outputs and deliverables, and a description of evaluation criteria for each activity. Documentation must also be provided for specific roles and responsibilities, including third party contractors, and projected full-time equivalences for implementation. The EPA must approve a state's set-aside work plan before the funds are released for these projects.

Under the four percent administration and technical assistance set-aside, a state is only required to submit a work plan if providing funds for technical assistance to public water systems. In this event, only the portion used for technical assistance must be described within the work plan.

Public involvement is required and must seek "meaningful" public review and comment of the IUP. The following elements must be included in this review.

- The short and long-term goals of the program
- The priority system used to rank projects
- The priority lists of projects, including both the fundable and the comprehensive list
- The financial status of the program
- A description of the amounts of funds that the program will use for set-aside activities and the intended use of those funds

Examples of activities that would be considered adequate public comment would be:

- Distributing the IUP to a wide audience
- Holding public meetings/hearings or participating in conferences
- Publishing newsletters or newspaper notices
- Mailing program information to interested parties
- Developing Internet websites
- Producing public service announcements for radio or television
- Establishing advisory groups to develop and review policies

See Appendix C for a general review of the state capitalization grant application process.

If certain SDWA capacity development requirements are not met the EPA will withhold a portion of a DWSRF's capitalization grant. Twenty percent of funds will be withheld from states that do not have the legal authority or other means to ensure that community and nontransit, noncommunity water systems that began operations after October 1, 1999, demonstrate technical, managerial, and financial capacity for each drinking water regulation. Twenty percent withholding will also occur for states that are not implementing a capacity development strategy, including adherence to all federal reporting requirements to help systems gain capacity. These two withholding provisions are not additive. A maximum of only twenty percent may be withheld for either of these two violations. An additional twenty percent may also be withheld if the state has not adopted and is not implementing a water system operator certification program.

If a state loses primary enforcement authority under SDWA the EPA will withhold the state's entire capitalization grant. EPA may use these funds to administer primacy in that state. The balance of funds not used by EPA to administer primacy will be reallocated to other compliant state DWSRF programs. A state will be eligible for future allotments from funds appropriated in the next fiscal year after primacy is restored.

Federal requirements for the state match of the fund indicate the state must provide a match to the fund equal to or greater than twenty percent of the entire capitalization grant. Other state agencies may not make a loan to the DWSRF to provide the match; however, they may assist the DWSRF in acquiring matching funds through an external debt offering.

The EPA allots federal DWSRF funds to the states according to a formula that reflects their proportional share of drinking water needs. These funds are available to the states during the fiscal year in which they are authorized and during the following fiscal year. Any amount not obligated at the end of this period is reallocated to all remaining states that have already obligated their funds.

DNR does comply with all required procedures however, the reports can seem very unclear to someone unfamiliar with the large amount of information provided in these reports. Oversight recommends a combined Drinking Water State Revolving Fund and Clean Water State Revolving Fund annual report for public distribution. This report should not be as complex as previous reports provided to the EPA. It should include a brief explanation of the regulations and explanations provided in the EPA reports. As well as a more general approach including what is being funded, federal and state percentages for each project, and a general description of each project. Also, there should be more concentration on providing information to communities regarding the program as well as the other funding sources available for funding these projects.

Comment 2

The Environmental Improvement and Resources Authority (EI ERA) is a quasi-governmental agency that serves as the financing arm for the Department of Natural Resources. The primary purpose is to provide financial assistance for energy and environmental projects and to protect the environment. The agency also conducts research, supports energy efficiency and energy alternatives and promotes economic development. The five primary initiatives of the EI ERA are:

1. The Missouri State Revolving Fund was established in cooperation with the Missouri Clean Water Commission and the U.S. Environmental Protection Agency (EPA) with the EI ERA's assistance. The SRF provides loan monies to communities and districts for construction of wastewater and drinking water projects.
2. The EI ERA, in cooperation with the Department's Energy Center, developed the Missouri Energy Efficiency Leveraged Loan Program to provide funds to city and county governments and public school districts for energy efficiency improvements in facilities or buildings.
3. The EI ERA coordinates recycling market development to expand and support recycling and waste recovery through the Missouri Market Development Program.
4. The EI ERA issues Private Activity Bonds for pollution prevention projects that qualify under the U.S. Tax Code.
5. In FY 2006 the EPA awarded EI ERA a grant to establish and manage a revolving loan and subgrant fund to clean up contaminated properties known as Brownfields. This program is managed by the EI ERA with oversight of the cleanup provided by the DNR's Voluntary Cleanup Program.

Authorization for this program is provided by the following:

Safe Drinking Water Act (1996)

US Tax Code

42 USC 9601

Comprehensive Environmental Response, Compensation &
Liability Act, as amended

RSMo. 260.005-260.125

EIERA authorizing statutes

RSMo. 640.100-640.140

Missouri Drinking Water Act

RSMo. 651.651-651.686

Energy Loan Program

RSMo. 644

Missouri Clean Water Law

RSMo. 260.335

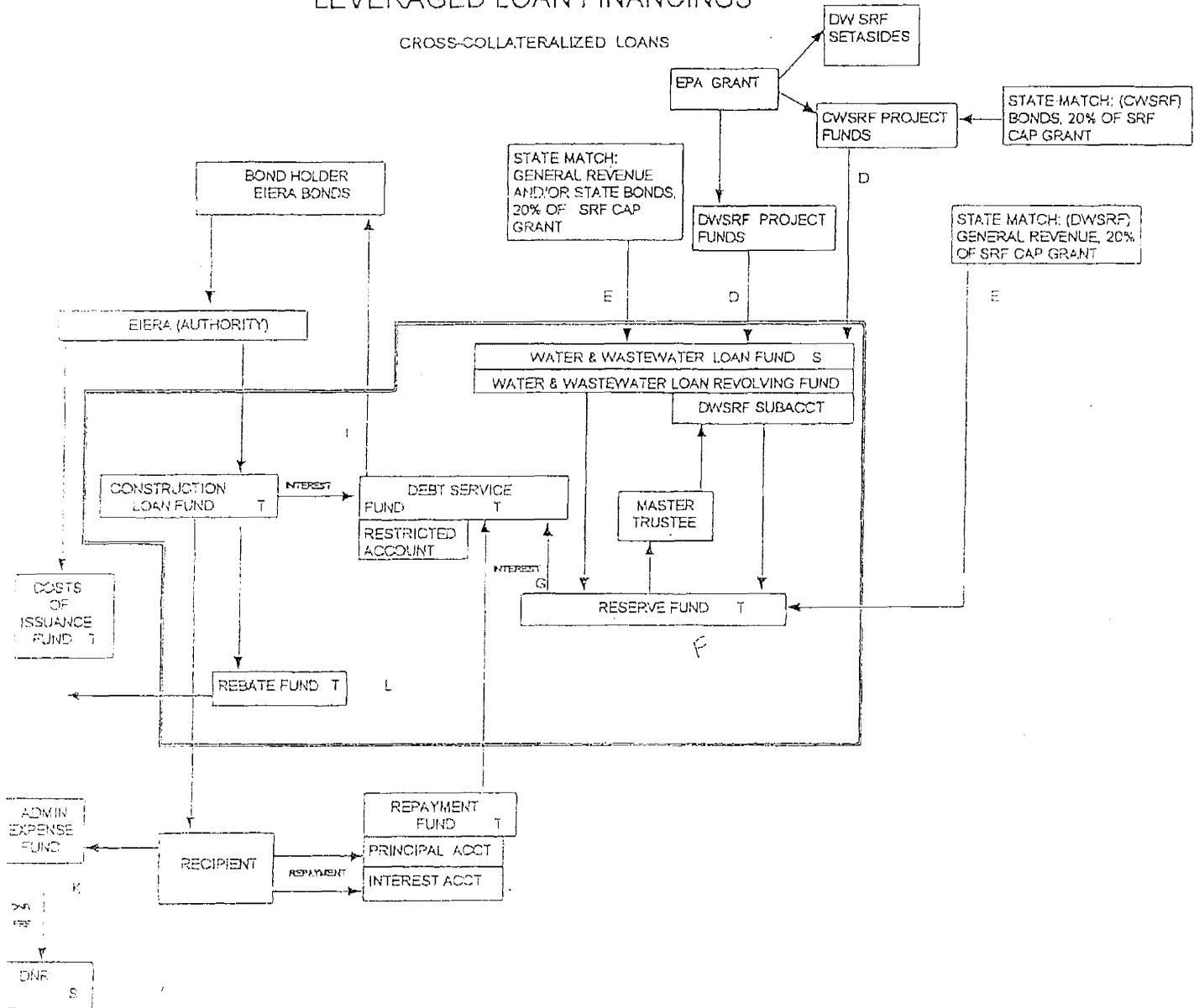
Solid Waste Management/Market Development

There are federal matching requirements in the Clean Water State Revolving Fund Capitalization and Drinking Water Capacity Development. These grants require a 20% state match. This match was traditionally funded through the sale of State Water Pollution Bonds or State General Revenue. However, in 2004 the EIERA began providing the match through the sale of its bonds for the Drinking Water Program. This funding mechanism was also duplicated for the Clean Water SRF program in 2005. This funding was to relieve the state of the need to use state funds to pay debt service on state match bonds.

The following flow chart shows the flow of funds under the cross-collateralized leveraged loan program. As credit enhancement, reserve releases from the bond reserve funds of the Clean Water State Revolving Fund (CWSRF) projects and Drinking Water State Revolving Fund (DWSRF) loan projects passes through the master trustee prior to deposit into the Water and Wastewater Revolving Loan Fund.

MISSOURI STATE REVOLVING FUND LEVERAGED LOAN FINANCINGS

CROSS-COLLATERALIZED LOANS



T = ACCOUNT HELD BY TRUSTEE
S = ACCOUNT HELD BY STATE TREASURY

A brief description of the flow chart follows.

Construction Loan - These funds are generated through the issuance of EIERA bonds based on indebtedness issued by each recipient, typically general obligation or revenue bonds (A). The net proceeds of the EIERA bonds issuance are placed with a trustee bank in a fund titled the "Construction Loan Fund" (B). As construction progresses, moneys are released from the Construction Loan Fund to pay contractors, suppliers, and consultants (C). The recipient is obligated to pay back all funds received from the Construction Loan Fund, plus any interest charges and fees which are not covered by investment earnings.

Interest Subsidy - Funds used for the reserve fund will be provided from the Water and Wastewater Loan fund (WWLF) for CWSRF and General Revenue for DWSRF. The WWLF is capitalized by grants from the Environmental Protection Agency (D) and from the sale of Missouri Water Pollution Control Bonds for the CWSRF. In the DWSRF loan program, the WWLF is capitalized by grants from the Environmental Protection Agency only, with the state match for the entire capitalization grant provided State General Revenue going directly to the bond reserve fund (E). Each time construction funds are released from the Construction Loan Fund (C) about 70 percent of that amount will be transferred from the Water and Wastewater Loan Fund or 33% from the Drinking Water State Revolving Loan Fund to the Reserve Fund (F), held by the trustee bank. Investment earnings on the Reserve Fund will be used to pay a portion of the interest cost of the EIERA bonds (G), reducing the interest liability of the recipient. The reserve account restricts earnings to prevent arbitrage. The restricted account to which the Master Trustee deposits funds in order to meet payment obligations. Any interest earnings deposits are transferred to the program from which they originated and not to the defaulting community.

Repayments - Construction loan repayments must begin within one year after the constructed facilities are placed into operation. The payment schedules will generally consist of semiannual interest payments, and annual principal payments (H) that are held by the trustee bank in separate recipient accounts (repayment fund) outside the SRF for a maximum of 180 days. Interest earnings on these recipient accounts are credited to the account and used when the payment is made to the bondholders. When a payment is due the bond holders, the trustee bank will make interest payments by combining the recipient's construction loan earnings, the interest subsidy on the reserve and the interest payments by the recipient, transferring them to EIERA's bond holders (I). Each principal payment will be made by the trustee bank from funds paid by the recipient to the trustee. Principal payments will also trigger the transfer of a proportionate amount of the principal in the Reserve Fund back to the proper subaccounts of the Water and Wastewater Loan

Revolving Fund (WWLRF) (J). These revolving funds can then be used again to support new construction projects.

Previously, the Department offered leveraged loans to provide financial assistance however, as a result of the market downturn they are in the process of developing a new structure for the Clean Water SRF program participants.

It should also be noted that the Department is closely monitoring the availability of funds in conjunction with the demand for those funds. Previously, the department offered leveraged loans, however, due to the market downturn in the economy during state fiscal years 2008 and 2009 they will no longer offer leveraged loans. Previously, these services were provided in contracted services with Guaranteed Investment Contracts (GICs) which were utilized in conjunction with leveraged loans. The Department is now developing a new structure for the Clean Water SRF program participants.

It should also be noted that the Department plans to evaluate future program structures to ensure the program remains a stable and viable source for the Clean Water funding needs.

Oversight's review indicates the short term goals of the Clean Water State Revolving Fund indicate revising the structure of the loan program to allow for additional flexibility. According to Oversight's review this would include the implementation of a hybrid cash flow model loan program or a reserve fund model. However, there is no written description of this structure or how the additional flexibility will be modeled. Also, there is no written implementation of the hybrid cash flow loan program.

Oversight recommends a written description of the structure as well as a time line including when the indicated changes would occur.

Comment 3

As was previously stated, Section 302 of the Safe Drinking Water Amendment of 1996 authorized states to transfer funds between the Clean Water State Revolving Fund (CWSRF) and the Drinking Water State Revolving Fund (DWSRF) or vice versa. According to information reviewed, the assumption was that some states would want the flexibility to operate their state revolving fund programs in a manner that would allow one fund to support the other to address their most pressing needs. According to the provisions in the amendment, it allowed the Governor of the State to transfer an amount equal to 33 percent of the DWSRF grant to the CWSRF program or an equivalent amount from the CWSRF to the DWSRF program. It also indicated that states were required to wait until one year after establishing their DWSRF fund before making a transfer and they could only make transfers prior to October 1, 2001.

According to information reviewed, the DWSRF was designed to provide funding for drinking water infrastructure and in the first few years of implementation there were challenges. The information also indicated that Missouri's DNR did perform a transfer of funds from the CWSRF to the DWSRF. Oversight also assumes this transfer was incurred in anticipation of excessive demand for DWSRF loan funds.

The review indicated that in state fiscal year 2001 the Department of Natural Resources, with the approval of the Safe Drinking Water Commission and the Clean Water Commission, transferred \$10,475,000 from the CWSRF to the DWSRF. According to information reviewed, the transfer was made to "off set" the anticipation of excessive demand for DWSRF loan funds with a portion of the large, unobligated loan fund balance in the CWSRF at the time. This was also indicated in a letter to the State Revolving Fund Branch, U.S. Environmental Protection Agency, Region VII, that stated "The need to effect the 'transfer' is based on existing loan commitments, anticipated commitments in calendar 2002, and a shortfall of funds in our DW repayment sub-account sufficient to honor these commitments in light of the current hold on ACH draws." (Appendix D)

According to a memorandum from DNR to the Attorney General's Office there were two different approaches for potential implementation of the transfer. One approach would be at the EPA level and would only make the transfer prior to September 30, 2001 and after that date there would be no repayment provision. The second approach would be to instead "reallocate" funds within the Water and Wastewater Revolving Loan Fund from the Clean Water sub-account to the Drinking Water sub-account. According to the memo ".... 1) as capitalization grant funds are received from the EPA they are deposited into the Water and Wastewater Loan Fund (this is a wash account), 2) as loans are repaid the principal and any interest thereon are deposited into the Water and Wastewater Revolving Loan Fund (644.123), 3) the Water and Wastewater Revolving Loan Fund (established by the Office of Administration) is a sub-fund of the Water and

Wastewater Loan Fund established under 644.122, and 4) the Water and Wastewater Revolving Loan Fund is comprised of the CW and DW sub-accounts.” Additional information contained in the memo stated “The reallocation of these funds, for whatever period, is merely a formalized accounting procedure as outlined by EPA. At the federal budget level, the reallocation might be better described as a transfer since they represent two budget line items. At the state level however, and certainly under this option since it is being effected at the state level, reallocation might better describe the effect of our effort since the funds reside in the same account (0602). The requested certification merely attests to our ability to do so.” The memo also states “Clearly it was the intent of the legislature to give complete authority over the use of the fund to the commissions and the department.”

Information reviewed also indicated that the initial “transfer” (reallocation) would probably take a “few” years to repay due to the size of the fund. This applied to the \$10,475,000 transfer/reallocation. In addition to this transfer/reallocation it appears there could have been an additional recommendation for the authorization to transfer up to \$10,000,000 from the Clean Water repayment sub-account to the Drinking Water repayment sub-account. This adjustment was recommended to “remedy cash flow needs”. According to the information reviewed the authorization to transfer would apply to FY 2003. However, it appears that this transfer never occurred.

Although it appears the “transfer/reallocation” was authorized according to federal and state guidelines the information provided is misleading. Originally the information stated this was a transfer however additional information concluded it should be called a reallocation. Also, it was stated this transfer/reallocation would be repaid at the earliest possible date. However, additional information provided the possibility of another transfer. Included in this request it also stated that the transfer/reallocation would be repaid at the earliest possible date and then stated that it could take a few years to repay due to the size of the fund. This information is vague because it does not provide a time line for the repayment of the transfer/reallocation. It does not provide any guidelines other than it would be repaid at the earliest possible date. The transfer/reallocation was performed in 2001. Our review was performed in 2010. Our review indicates the repayment will be performed in SFY 2011 because according to information reviewed “there appears to be unprecedented demand for loans through the CWSRF. As a result, the Department is proposing to transfer.”

Oversight recommends clearer guidelines if funds will be transferred from one revolving fund to another. If DNR intends to repay a transfer there should be a specific time line for the repayment. In the transfer/reallocation of 2001 the statements were vague. Although there were indications the transfer/reallocation would be repaid at the earliest possible date, ten years is beyond that time. Also, if DNR “reserves the right to make additional transfers in the future” there should be specific guidelines on how this will occur, what precedents would indicate the possibility of a transfer and if a transfer is done how and when the repayment will occur.

APPENDIX A

FY1998

1. President Clinton presented the Administration's budget request for FY1998 in February 1997. For water infrastructure and state and tribal assistance, the request totaled \$2.793 billion, consisting of \$1.075 billion for clean water SRF grants, \$725 million for drinking water SRF grants, \$715 million for consolidated state environmental grants, and \$278 million for special project grants.

House and Senate committees began activities on FY1998 funding bills somewhat late in 1997, due to prolonged negotiations between Congress and the President over a 5-year budget plan to achieve a balanced budget by 2002. After appropriators took up the FY1998 funding bills in June, the House passed EPA's appropriation in H.R. 2158 (H.Rept. 105-175) on July 15. In the State and Tribal Assistance Grants account, the House approved \$3.019 billion, consisting of \$1.25 billion for clean water SRF grants (\$600 million more than FY1997 levels and \$175 million more than requested by the President), \$750 million for drinking water SRF grants (\$425 million less than FY1997 levels, but \$25 million more than the request), \$750 million for state environmental assistance grants, and \$269 million for special projects. The latter included funds for the special projects requested by the Administration but at reduced levels (\$149 million total for these projects), plus \$120 million in special project grants for 21 other communities.

The Senate passed a separate version of an FY1998 appropriations bill on July 22, 1997 (S. 1034, S.Rept. 105-53). It provided \$3.047 billion for the State and Tribal Assistance Grants account, consisting of \$1.35 billion for clean water SRF grants, \$725 million for drinking water SRF grants, \$725 million for state environmental assistance grants, and \$247 million for special project grants. The Senate bill provided the amounts requested by the Administration for U.S.-Mexico border projects, Texas *colonias*, and Alaskan Native Village projects (but no special funds for others requested by the President), plus \$82 million for 18 special project grants for other communities identified in report language.

Conferees reached agreement on FY1998 funding in early October 1997 (H.R. 2158, H.Rept. 105-297). The final version passed the House on October 8 and passed the Senate on October 9. President Clinton signed the bill October 27 (P.L. 105-65). As enacted, it provides \$3.213 for the State and Tribal Assistance Account, consisting of \$1.35 billion for clean water SRF grants, \$725 million for drinking water SRF grants, \$745 million for consolidated state environmental assistance grants, and \$393 million for 42 special purpose project and special community need grants for construction of wastewater, water treatment and drinking water facilities, and groundwater protection infrastructure. It included the following amounts for grants requested by the Administration:

- \$75 million for U.S.-Mexico border projects,
- \$50 million for Texas *colonias*,
- \$50 million for Boston Harbor wastewater needs,
- \$10 million for New Orleans,

\$3 million for Bristol County, MA, and

\$15 million for Alaskan Native Village projects.

The final bill also provided funds for all of the special purpose projects included in the separate House and Senate versions of the legislation, plus three projects not included in either earlier version.

Bill language was included which allows states to cross-collateralize clean water and drinking water SRF funds, that is, to use the combined assets of amounts appropriated to State Revolving Funds as common security for both SRFs, which conferees said is intended to ensure maximum opportunity for states to leverage these funds. Senate committee report language said that the conference report on the 1996 Safe Drinking Water Act Amendments had stated that bond pooling and similar arrangements were not precluded under that legislation. The appropriations bills language was intended to ensure that EPA does not take an unduly narrow interpretation of this point which would restrict the states' use of SRF funds.⁽¹⁴⁾

On Nov. 1, 1997, President Clinton used his authority under the Line Item Veto Act (P.L. 104-130) to cancel six items of discretionary budget authority provided in P.L. 105-65. The President's authority under this Act took effect in the 105th Congress; thus, this was the first EPA appropriation bill affected by it. The cancelled items included funding for one of the special purpose grants in the bill, \$500,000 for new water and sewer lines in an industrial park in McConnellsburg, PA. Reasons for the cancellation, according to the President, were that the project had not been requested by the Administration; it would primarily benefit a private entity and is outside the scope of EPA's usual mission; it is a low priority use of environmental funds; and it would provide funding outside the normal process of allocating funds according to state environmental priorities.⁽¹⁵⁾

However, in June 1998, the Supreme Court struck down the Line Item Veto Act as unconstitutional, and in July the Office of Management and Budget announced that funding would be released for 40-plus cancellations made in 1997 under that Act (including those cancelled in P.L. 105-65) that Congress had not previously overturned. (For additional information, see CRS Issue Brief IB89148, Item Veto and Expanded Impoundment Proposals.)

<http://ncseonline.org/nle/crsreports/water/h2o-35.cfm>

APPENDIX B

Missouri Revised Statutes

Chapter 644

Water Pollution

Section 644.122

August 28, 2010

Water and wastewater loan fund established--use of funds--deposits, disbursements--exempt from transfer to general revenue.

644.122. 1. There is hereby created in the state treasury for use of the department a fund to be known as "The Water and Wastewater Loan Fund". All moneys received by the department for activities authorized in subdivisions (1), (3), (4), (5), and (6) of subsection 2 of this section shall be deposited in the fund for the use of the commission. Moneys received for the drinking water state revolving fund shall be used for the purposes identified in the federal Safe Drinking Water Act as amended and shall be accounted for separately.

2. The commission is hereby authorized to expend or use moneys deposited in the water and wastewater loan fund, upon appropriation by the general assembly to the department, for one or more of the following purposes as the same relate to the construction of public drinking water and water pollution control projects as authorized by the commission pursuant to this chapter:

(1) To make loans to any county, instrumentality of the state, municipality, public water district, public sewer district, community water system, nonprofit noncommunity water system or any combination of the same, or any entity eligible pursuant to the Safe Drinking Water Act, as amended, or the Clean Water Act, as amended;

(2) For the costs of administering programs and projects financed, in part, by the water and wastewater loan fund;

(3) As a source of revenue or security for the payment of principal and interest on revenue or general obligation bonds or notes issued by the state or any agency or instrumentality thereof;

(4) To buy or refinance the debt obligation of any county, instrumentality of the state, municipality, public water district, public sewer district, community water system, nonprofit noncommunity water system, or any combination of the same;

(5) To guarantee, or purchase insurance for, notes or obligations of any county, instrumentality of the state, municipality, public water district, public sewer district, community water system, nonprofit noncommunity water system or any combination of the same, where such action would improve credit market access or reduce interest rates;

(6) To provide loan guarantees for similar revolving funds established by any county, instrumentality of the state, municipality, public water district, public sewer district, or any combination of the same; and

(7) To earn interest on the water and wastewater loan fund accounts.

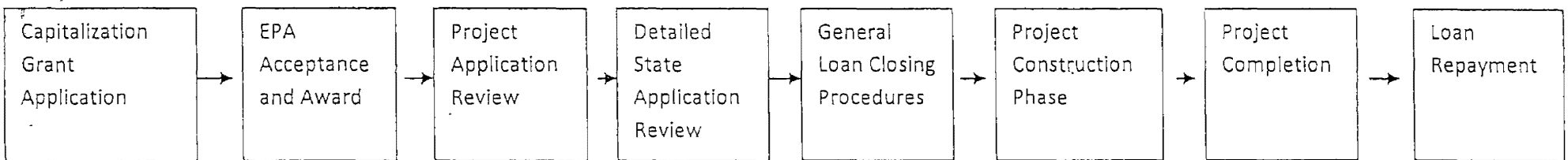
3. The unexpended balance in the water and wastewater loan fund at the end of the biennium shall not be transferred to the ordinary revenue fund of the state treasury and accordingly shall be exempt from the provisions of section 33.080 relating to transfer of funds to the ordinary revenue funds of the state by the state treasurer.

4. For purposes of this section, public drinking water and water pollution control projects shall include, but not be limited to, the planning, design, and construction of water or wastewater facilities, or both, and the planning, design, and construction of nonpoint source control facilities identified in a nonpoint source control plan prepared by the department of natural resources.

(L. 1987 H.B. 497, A.L. 1991 S.B. 185, A.L. 1993 H.B. 566, A.L. 1998 H.B. 1161, A.L. 2000 S.B. 741)

APPENDIX C

Flow chart of Capitalization Grant Application Process



APPENDIX D

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Bob Holden, Governor • Stephen M. Mahood, Director

DEPARTMENT OF NATURAL RESOURCES

DIVISION OF ENVIRONMENTAL QUALITY
P.O. Box 176 Jefferson City, MO 65102-0176

MAR 28 2002

Mr. Pradrip L. Dalal, P.E., Chief
State Revolving Fund Branch
U.S. Environmental Protection Agency, Region VII
901 N. 5th Street
Kansas City, KS 66101

Dear Mr. Dalal:

The Missouri Clean Water State Revolving Fund (CW SRF) has the need to temporarily transfer up to 10 million dollars to the Drinking Water State Revolving Fund (DW SRF). The transfer would reallocate (transfer) funds within the Water and Wastewater Revolving Loan Fund (0602, the SRF repayment account) from the CW sub-account to the DW sub-account. The sub-accounts were established by and are maintained by the Department of Natural Resources (DNR) to track the two in accord with grant conditions established by EPA and 644.122.1.

The need to effect the "transfer" is based on existing loan commitments, anticipated commitments in calendar 2002 and a shortfall of funds in our DW repayment sub-account sufficient to honor these commitments in light of the current hold on ACH draws.

The reallocation of these funds is similar to last year's transfer. It is our intent to replenish the CW sub-account with DW funds as soon as practicable. The proposed transfer should not affect projects listed in the FY 2003 Intended Use Plan (IUP). The three or four "impacted" projects will not be ready to secure funding for at least one year; therefore, there will be no overall affect to the IUP. Leaving these projects on the fundable list and thereby "over committing" our funds has long been recommended by your staff. The net effect should be that we accelerate the use of the fund and our loan commitments. Transfers between the funds are discussed in both IUPs.

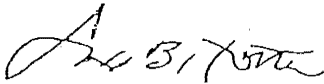
Please find the enclosed copy of the Attorney General's Certification of State's Authority to Transfer Funds dated August 1, 2001.

Mr. Pradrip L. Dalal, P.E.
Page Two

Your immediate attention is sincerely appreciated. Please don't hesitate to call me at (573) 751-5998 if you have any questions.

Sincerely,

WATER PROTECTION AND SOIL CONSERVATION

A handwritten signature in dark ink, appearing to read "S. B. Totten", written in a cursive style.

Scott B. Totten
Division Director

SBT:csn

Enclosure

